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CHARLES ELMORE

Supreme Court of the United States

OCTOBER TERM, 1932.

No. 227.

Consolidated Cause

RICHARD REID ROGERS,
Plaintiff-Petitioner,

against

GUARANTY TRUST COMPANY OF NEW YORK, JUNIUS PARKER, GEORGE W. HILL, C. F. NEILEY, A. C. MOWER, VINCENT RIGGIO, CHARLES A. PENN, J. B. HARVIE, R. J. BOYLAN, C. S. KEENE, J. K. FLETCHER and THE AMERICAN TOBACCO COMPANY,
Defendants-Respondents.

RICHARD REID ROGERS,
Plaintiff-Petitioner,

against

THE AMERICAN TOBACCO COMPANY and T. R. TAYLOR,
Defendants-Respondents.

BRIEF ON BEHALF OF PLAINTIFF-PETITIONER

RICHARD REID ROGERS,
Petitioner, pro se.

EVAN SHELBY,
of Counsel.

The Heela Press, 225 Varick St., N. Y. Tel. WAlker 5-1480

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Supreme Court of the United States

RICHARD REID ROGERS, Plaintiff-Petitioner, against GUARANTY TRUST COMPANY OF NEW YORK, JUNIUS PARKER, GEORGE W. HILL, C. F. NEILEY, A. C. MOWER, VINCENT RIGGIO, CHARLES A. PENN, J. B. HARVIE, R. J. BOYLAN, C. S. KEENE, J. K. FLETCHER and THE AMERICAN TOBACCO COMPANY, Defendants-Respondents.	Consolidated Cause.
RICHARD REID ROGERS, Plaintiff-Petitioner, against THE AMERICAN TOBACCO COMPANY and T. R. TAYLOR, Defendants-Respondents.	

BRIEF ON BEHALF OF PLAINTIFF-PETITIONER.

This is a consolidated cause involving: (1) the original validity of a so-called stock employees' plan of The American Tobacco Company, whereby 312,968 shares of the company's common stock B were set aside for sale to such employees as might be designated by the president pursuant to authority to be granted him by the board of directors; and (2) the validity of the partial execution of the plan, whereby 56,712 shares were subsequently sold chiefly to directors at $87 a share less than its then market value.

Status of Litigation.

There were two actions: the first was instituted in the Supreme Court of New York County by plaintiff, a stockholder and citizen of New York, against The American Tobacco Company, T. R. Taylor and other directors of the Tobacco Company (Rec. p. 1), to cancel the stock issued, to enjoin the issue of further stock, and to hold the directors responsible for attempting to carry out an alleged illegal transaction. This action was removed to the United States District Court for the Southern District of New York March 9, 1931, by the defendants The American Tobacco Company and T. R. Taylor, upon the ground that they were citizens of a different State from the plaintiff, to wit, New Jersey, and that the cause involved a separable controversy as to them (p. 2). On April 6, 1931, this action, without objection, was discontinued as to all defendants except The American Tobacco Company and Taylor, the removing defendants (p. 2). Further facts having been ascertained, including the participation by the Guaranty Trust Company of New York, which was found to be in actual possession of the stock sought to be cancelled, a second action was begun by the petitioner in the Supreme Court of New York against the Guaranty Trust Company of New York, Junius Parker, George W. Hill, C. F. Neiley, A. C. Mower, V. Riggio, Charles A. Penn, J. B. Harvie, R. J. Boylan, C. S. Keene, J. K. Fletcher and The American Tobacco Company (p. 2). This action was removed to the United States District Court for the Southern District of New York by The American Tobacco Company and Charles A. Penn, April 25, 1931, upon the ground that they were citizens of different States from the plaintiff and that the action involved a separable controversy as to them (p. 2). The defendant Penn subsequently died. On November 7, 1931, the District Court denied a motion to remand the second action to the State court (53 Fed., 2nd, 398), and entered an order consolidating the two actions (p. 3). The amount involved in each action exceeds $3,000.

Thereafter, a motion having been made by the plaintiff in the consolidated cause: (1) to strike out the separate defenses in the answers of the appearing defendants on the ground of insufficiency; (2) for a decree on the pleadings for the relief prayed for in the amended complaint; and (3) in the alternative, for an injunction *pendente lite* (p. 4); the motion came on to be heard in the District Court December 24, 1931. On February 23, 1932, the District Court, after holding that "the matters raised in the amended complaints involve the internal management of a foreign corporation, to wit, a New Jersey corporation, and present questions for construction of New Jersey statutes," dismissed each of the bills of complaint "in the exercise of its discretion" without prejudice to the enforcement of the rights of the plaintiff, if any, in the courts of New Jersey (p. 281). An appeal was taken by plaintiff from this decree to the Circuit Court of Appeals for the Second Circuit. On June 3rd the decree of the District Court was affirmed, Manton, P. J., and Chase, J., voting for affirmance and Swan, J., dissenting. Reference is made to the opinion of the District Court (p. 273), to the opinion of the majority of the Circuit Court of Appeals (p. 287), and to the dissenting opinion of Swan, J. (p. 297). The opinion of the District Court will also be found reported in 60 Fed. (2nd) at p. 106; and the opinion of the Circuit Court of Appeals in 60 Fed. (2nd) at p. 114.

Because of the failure to obtain service of some of the defendants and the death of another, as appears above, the only parties now before the Court are the Guaranty Trust Company of New York, Junius Parker, George W. Hill, Vincent Riggio, J. B. Harvie, R. J. Boylan, T. R. Taylor and The American Tobacco Company.

The detailed facts set up in the amended complaint were ascertained as the result of an examination of the Tobacco Company's books, allowed by an order of the Supreme Court of New York County, *In re Rogers* v. *American Tobacco Co.*, 143 Misc. Rep. 306, affirmed by the Appellate Division of the Supreme Court, and appeal denied by the Court of Ap-

peals of New York. Only the conclusions drawn by the pleader therefrom were denied by the answers. The case was, therefore, fully presented by the pleadings.

Facts.

The essential facts were as follows:

On June 25, 1930, the board of directors of The American Tobacco Company, all of whom were interested parties, passed resolutions (1) approving a reduction in the par value of the common and common stock B of the company from $50 to $25 per share, the issue of two shares of the new stock for one share of the old, and an increase in the authorized common stock to 2,000,000 shares and the authorized common stock B to 4,000,000 shares;* and (2) advising the approval by the stockholders of an employees' stock subscription plan pursuant to Chapter 175, Laws of 1920, State of New Jersey, Smith on N. J. Corp. Law, p. 120.

The material parts of this statute are as follows:

> "1. Any stock corporation formed under any law of this state may, upon such terms and conditions as may be determined in the manner hereinafter designated, provide and carry out a plan or plans for any or all of the following purposes:
>
> (a) The issue or the purchase and sale of its capital stock to any or all of its employees and those actively engaged in the conduct of its business or to trustees on their behalf and the payment for such stock in installments or at one time with or without the right to vote thereon pending payment therefor in full, and for aiding any such employees and said other persons in paying for such stock by contributions, compensation for services, or otherwise.
>
> * * * * * * *
>
> 2. (b) Where the corporation has been formed without the said charter or by-law provisions [i. e.,

*Note: The common stock and common stock B have the same financial rights; the common stock alone electing directors.

without appropriate charter provisions as here] the board of directors shall first formulate such plan or plans and pass a resolution declaring that in its opinion the adoption thereof is *advisable,* and shall call a meeting of the stockholders to take action thereon. * * *

3. Any plan adopted as aforesaid may be recalled, abolished, revised, amended, altered or changed in the same manner as is herein provided for its adoption; * * *

4. The privileges and powers conferred by this act shall be deemed to be in addition to and independent of any and all powers and authority conferred by any other law or laws, and not in restriction or limitation of any of the powers now permitted to corporations of this state. (L. 1920, C. 175.)"

The plan advised by the directors, and submitted for the stockholders' approval, provided (p. 47):

That its purpose was to accord to such employees of The American Tobacco Company as may be selected as therein provided, by way of additional compensation for *services to be rendered* an opportunity to purchase shares of stock of the company. The manner of executing the plan was stated to be that the board of directors may, at such times as it may determine by way of additional compensation for services to be rendered, offer and allot such stock for subscription to employees in such amounts, to such persons, at such prices not less than the par value of the shares allotted payable in full or in instalments, "all as shall be determined with respect to each offering of stock to each individual pursuant to authority to be granted by the board of directors to the President for such purpose." It was further provided (p. 49) that no employee shall be deemed ineligible to the benefits of the plan by reason of being also a director of the company. Finally, it was stated that the plan may be recalled or amended as provided by Section 3 of the law above cited.

At the stockholders' meeting called for July 28, 1930, more than two-thirds of the stockholders present voted approval

of the foregoing resolutions. Plaintiff's stock was voted against both resolutions; and a protest was read in his behalf which is set out in paragraph 10 of the complaint (p. 15).

Under the resolutions thus adopted, 312,968 shares of common stock B were made available for sale to employees, including directors (p. 16); every director, with one possible exception, being likewise an employee of the company (p. 100).

Thereafter, on January 28, 1931, the directors of the company met in New York City and approved a sale at $25 a share of 56,712 shares of common stock B on the recommendation of the president as follows (p. 23):

	Shares
To the president himself	13,440
To other directors	19,330
To 521 other managers and higher employees	22,162
To others grouped by the company under the head "Miscellaneous" (p. 153) and not employees in the strict sense, as follows:	
One of the trustees	400
A member of the firm's counsel	980
The company's advertising agent	250
Two others	150
	56,712

No stock was allotted to any employee of lower rank than factory sub-assistant (p. 100).

Every member of the board of directors present at this meeting participated in the allotment at $25 a share; each director present being recorded as voting upon the allotments to all other directors, but as not voting on his own particular allotment (p. 24; Ex. F, p. 79).

On the day the stock was thus sold at $25 a share it had a market value of $112 a share (p. 16).

The procedure adopted by the directors for carrying out the foregoing distribution of stock was as follows:

The stock was sold in the first instance for $25 a share cash to the Guaranty Trust Company, which was authorized

as trustee to borrow from itself as an individual the requisite funds. The Guaranty Trust Company then allowed the individuals selected by the president of the Tobacco Company and its directors to subscribe for their several allotments at the same price, it being stated in the agreement that this was by the way of additional compensation for services to be rendered between the date of the agreement, January 31, 1931, and December 31, 1931 (p. 110). Until December 31, 1931, no subscriber could take up his stock (p. 113). Payments were to be made on the purchase price from time to time, corresponding to the amount and date of the regular quarterly dividend of $1.25 for each quarter (p. 112). If any subscriber severed his connection with the company prior to December 31, 1931, it was left to the *trustees* to say whether he should have his allotment or not (p. 115).

Specification of Errors.

The following errors were specified in the application for writ of certiorari, and are here set out in the order of events:

1. The preliminary resolution of the board of directors required by the statute "advising the adoption of the plan" was not passed by a quorum of disinterested directors, and was therefore of no effect.

2. There was such concealment of important facts which the stockholders were entitled to know, and of intention upon the part of the management, as constituted actual or constructive fraud and invalidated the transaction *ab initio*.

3. The plan submitted, inasmuch as it left everything to the president "pursuant to authority to be granted by the Board of Directors for such purpose," was not a definite or formulated plan such as Chapter 175, Laws of New Jersey, 1920, required.

4. In construing Chapter 175, Laws of 1920, as authorizing a sale of unissued stock in disregard of the stockholders' pre-emptive rights—a right recognized by the charter, com-

mon and statute law of New Jersey, and never taken away from petitioner by an amendment of the charter—the Circuit Court of Appeals gave effect to a State statute violating petitioner's charter contract, contrary to Article 1, Section 10 of the Federal Constitution.

5. Under the charter of the company (p. 54), the assets of the company can be used for two purposes only: (1) to put into a reserve fund to be applied to the acquisition of property, and (2) to declare dividends. In New Jersey the charter constitutes a contract of the shareholders *inter sese* which may not be changed by subsequent legislation, notwithstanding a reserved power to amend. The decision of the Circuit Court of Appeals gives effect to Chapter 175, Laws of 1920, in violation of this contract right, contrary to Article 1, Section 10 of the Federal Constitution.

6. The plan in providing for a sale of stock to employees "by way of additional compensation for services to be rendered" was contrary to the provisions of Chapter 175, Laws of 1920, and to the general corporation law of New Jersey.

7. The sale of the 56,712 shares of the stock by the directors, the larger part to themselves at $87 a share less than its then market value, was a violation of the directors' fiducial obligations and constituted waste.

8. The resolutions of the board of directors authorizing the distribution of the stock as aforesaid, inasmuch as every one of them participated in the profits, were invalid, because not passed by a quorum of a board of disinterested directors.

9. The sale of this stock "by way of additional compensation for services to be rendered" to the company to and including December 31, 1931, i. e., from January 28th to December 31, 1931, was invalid.

10. The Court below had jurisdiction of the consolidated cause.

11. There was no failure on the part of the plaintiff to comply with Equity Rule 27.

Of the foregoing errors, all of which were involved in the decision of the majority of the Circuit Court of Appeals, those numbered 1 to 6 relate to the original invalidity; those numbered 7 to 9 to the execution of the plan; and those numbered 10 and 11 to general questions. The discussion of these last two points is postponed to the end in order to avoid an unnecessary repetition of facts.

The foregoing points will now be discussed in their chronological order rather than in the order of their relative importance.

I.

Disqualification of directors by reason of personal interest to constitute a quorum for passage of the resolution advising the plan.

At the very threshold of this inquiry we are met with the fact that there was no valid resolution of the board of directors formulating a plan and advising its adoption, as Chapter 175, Laws of 1920, required. This was due to the fact that the directors in devising a plan whereby they qualified themselves as participants in potential profits (subsequently realized), at the same time disqualified themselves for voting therefor, or even from being counted as part of a quorum for passage of the necessary resolution. It will be observed that the law required, as a condition precedent to the submission of the plan for approval of the stockholders, that the directors should not only formulate the plan—in detail, as will presently be argued—but should pass a resolution declaring that its adoption was "advisable." The significance of the word "advisable" in this connection is not a matter of doubt. It seems to be settled by judicial utterance, and particularly by the decision of Pitney, J., in *Barrett* v. *Bloomfield,* 64 N. J. Eq. 425, 441, 445. That was a case where the directors were required by law to pass a resolution declaring the dissolution of a corporation "advisable." Judge

Pitney thus commented upon the meaning and importance of the word:

> "I am unable to conceive that the legislature intended that the managers, in judging upon and determining such advisability should take into consideration their own individual interests or that of their friends. * * * It is impossible to escape the conviction, on the case as now presented, that the managers were not acting disinterestedly in resolving that it was *advisable* to dissolve this institution, and that they were liable to be influenced in their judgment on that question by their individual interests, and hence were guilty of an abuse of the authority given them by the act invoked in their justification. *The whole transaction, therefore, upon well settled principles must be held to be prima facie void or voidable, and therefore subject to the review by the Court.*"

To precisely the same effect was the decision of the Court of Appeals of New York in *Kavanaugh* v. *Kavanaugh Knitting Co.*, 226 N. Y. 185, 192.

The law that directors are disqualified to vote, or to be counted for the purpose of making a quorum, as to any matter in which they are interested either actually or *potentially* (compare the citation from *Aberdeen Railway Co.* v. *Blaikie Brothers*, 1 McQueens App. Cas., p. 471, set out under Point VII of this brief), is established by overwhelming authority.

In *Thompson on Corporations*, Section 1257, it is said that "the cases are practically unanimous upon the proposition that a director who is personally interested in a proposition, or as to any matter pending before the board, is disqualified from acting, *and cannot be counted in estimating the quorum.*"

In *Spellman on Corporate Directors*, Section 179, it is said that the rule is established "by an overwhelming weight of authority."

The doctrine is firmly established in New Jersey (*Van Hook* v. *Somerville Mfg. Co.*, 5 N. J. Eq. 137, 169; *Met. T. & T. Co.* v. *Domestic T. & T. Co.*, 44 N. J. Eq. 568, 573; *Gardner* v. *Butler*, 30 N. J. Eq. 702; *Wall* v. *Utah Copper Co.*, 70 N. J. Eq. 17, 26).

In the Second Circuit Court of Appeals itself this question had previously been ruled upon. In *Enright* v. *Hecksher*, 240 Fed. 863, 872, Rogers, J., writing the opinion, said:

> "A director, whose interest in a matter disqualifies him from voting upon a resolution concerning it, cannot, according to the better opinion, be counted when the vote is taken. A director so disqualified by personal interest loses, *pro hac vice*, his character as a director, and so cannot be counted. *That is the law of New Jersey.*

While the decision of the Circuit Court of Appeals necessarily overrules this point, it is not discussed in the opinion.

II.

There was such concealment of important facts which the stockholders were entitled to know, and of intention upon the part of the management, as constituted either actual or constructive fraud and invalidated the transaction *ab initio*.

In the official circular, soliciting their proxies, sent out to the stockholders with the notice of meeting, the following statement was made by the president (p. 38):

> "I am certain that every stockholder will agree that it is to the company's interest that the organization which has made possible the great success which the Company has enjoyed during the past few years should be given every encouragement to continue in the Company's employ. It is the purpose of this plan, conforming with the policies of many large business enterprises, to offer inducements by way of stock ownership in the Company to the men who have made that success possible, so that the Company and its stockholders will have the assurance of their continued services in carrying the business forward with maximum enthusiasm and efficiency."

From this language the stockholders would naturally be led to infer that no other employees' stock plan had ever been put out by the company.

It appears, however, from the allegations of the complaint (par. 21; pp. 26, 27, 32, 33), not denied (p. 196), that the directors had already put into effect without the knowledge or approval of the stockholders (complaint, par. 22, p. 34; answer, par. XIX, p. 197), between the years 1914 and October, 1929, numerous preferred stock plans and two common stock plans from which the employees as a whole and the directors themselves had largely profited. Towards these various plans the company from the year 1914 as its contribution had set aside the sum of $240,000 a year (p. 32). The first preferred stock plans were confined to employees drawing salaries under $3,500 a year; but in the plans commencing in 1921, the salary limit was removed and the directors participated. There were also two common stock plans. In the first, put into effect in 1926, the company bought 21,500 shares of its old $50 par value stock, and sold it at cost, chiefly to the directors, the president taking 8,000 shares and seven other officers, all of whom but one were directors, from 250 to 5,000 shares each. The company, quite illegally, was forced to guarantee the payment of the directors' notes issued to pay for this stock and negotiated with banks in New York City (p. 26).

In the second common stock plan, put into effect in 1929, 51,750 shares of the old stock (equivalent to twice as many shares of the present stock), under the president's direction, without any previous authority from the board, were acquired by the company at $172 a share; and of this old stock 46,500 shares were thereafter sold by the directors to themselves at that price at a time when, as their own resolution states (p. 159), the stock was worth approximately $222 a share, or $50 a share more than they undertook to pay. Moreover, by a series of devious devices set up in sub-sections (e) and (f) of paragraph 21 of the complaint (pp. 29-34), $469,387.23 in 1929 and $917,625.96 in the year 1930 were misappropriated from the company's funds and applied in part payment of this stock.*

* These facts are not denied, the main answer contenting itself with the statement "that the Board of Directors, in their discretion, deemed it beneficial to the interests of the Company and its stockholders to use the moneys so saved in the manner and the form that they were used" (p. 196). The answer of the Guaranty Trust Company says nothing (p. 246).

In addition, the employees as a whole were receiving free medical services; and pensions costing the company $160,000 per annum (p. 25).

In addition, the president was receiving for the year 1930 a fixed salary of $168,000, and profit sharing in the amount of $842,000; the senior vice-president a fixed salary of $98,000, and profit sharing of $505,000; and the other vice-presidents fixed salaries of $50,000 each and profit sharings of from $409,000 to $505,000 (p. 25). All these facts were unknown to petitioner and were not disclosed to the stockholders (complaint, par. 22, p. 34; answers, pp. 197, 247).

The suppression of these facts, it is believed, constituted unfair dealing with the stockholders going to the very root of the entire transaction and invalidating the stock plan *ab initio*. Certainly, the duty to have disclosed these facts is settled by definite authority; and no authority to the contrary has been discovered.

As said in *General Investment Co.* v. *Am. Hide & Leather Co.*, 97 N. J. Eq. 214, 235:

> "No one can say in advance what the effect would have been upon the sentiment of any stockholder had he known all that he was entitled to know."

The reason for this rule is thus stated (p. 233):

> "Any other rule would permit the most ruthless destruction of the rights of the stockholders. Adroit management could frequently prepare a scheme in such innocent guise that ordinary stockholders would not be put upon their guard unless the full discharge of their duties by directors or officers presented the objectionable information which might cause individual stockholders to more carefully scan the proposed plan, and seek competent advice. Furthermore, if the law is to remain a scientific coordinated body of principles, doctrine and rules, there is no reason that fiduciary agents, such as directors, should not be subjected to the underlying directions of the law pertaining to trustees, which they are *sub modo*. There is no better rule established than that 'a trustee is bound to communicate to his beneficiary any knowledge or

> information he may have obtained affecting the beneficiary's interests, so far as they are embraced in or depend upon the trust or confidential relations.'"

In this very case, on the application for an examination of the books, the Special Term of the Supreme Court for New York County, Townley, J., said:

> "Another reason urged why the order should not be granted is the anomalous one that if a board of directors has done its duty as well as the present directors of The American Tobacco Company have performed theirs, a stockholder may not inquire into any plans they may have to benefit employees, considering themselves as employees. It is sufficient answer that the directors are nevertheless, regardless of the magnitude of their success, in the strictest fiduciary relation to the stockholders and must make a full disclosure of what profits they would make out of any scheme submitted by them for the approval of the company."
>
> *Matter of Rogers* v. *Amer. Tobacco Co.*, 143 Misc. Rep. 306, 309.

The opinion in the District Court (p. 275) disposed of this point by the statement that "the plaintiff asks no relief in this suit as to these matters." Actually the relief sought was and is the cancellation of the stock sale plan of 1930-1931 by reason of the deception thus practiced on the stockholders.

There was a further circumstance prior to the stockholders' meeting from which deception on the part of the management may be fairly inferred. In response to a letter written by Mr. Evan Shelby revoking some proxies, including plaintiff's, the following definite statement was made by the president (p. 50):

> "Subscriptions under the plan must be at a minimum but by no means or necessity a maximum price of $25.00 a share.
>
> I trust that in the light of this explanation you and Mr. Rogers will see fit to reconsider your opinion, and I am taking the liberty of enclosing two proxies."

Again, in the official circular sent out to the stockholders with the notice of the meeting, the following language appears (p. 39):

> "It is the expectation of your Board of Directors, if the program set forth in the enclosed notice is approved by the Stockholders, to declare an extra dividend of $4 per share on the Common Stock and Common Stock B now outstanding (the old stock), payable simultaneously with such one hundredth consecutive quarterly dividend, and also, commencing with the one hundred first consecutive quarterly dividend, to initiate the regular quarterly dividends on the *newly authorized shares* of Common Stock and Common Stock B at the annual rate of $5 per share."

This appeal to the acquisitiveness of the stockholders by the promise of an extra dividend of $4 a share "if the program is approved by the stockholders" sheds an unwholesome light upon the entire transaction, and emphasizes the concealment and deception practiced. In the protest read on plaintiff's behalf at the stockholders' meeting it was said:

> "The promise of an extra dividend of $4 is made contingent upon adoption of this resolution, although there is no logical connection between the two. This dividend therefore assumes the form of a bribe to induce stockholders indirectly to approve a proceeding favorable to some of the directors, officers and employees, but costly to the stockholders themselves" (p. 15).

In view of what was subsequently discovered, and what later transpired, it can hardly be said that this characterization was inexact.

Concealment is a badge of fraud; and of all the forms that fraud may take, perhaps there is none more craven, more insidious, or more pernicious in its consequences than suppression of the truth.

III.

The plan submitted inasmuch as it left everything to the president "pursuant to authority to be granted by the board of directors for such purpose" was not a definite or formulated plan such as Chapter 175 L. of New Jersey, 1920, required.

The law (Chap. 175) required the directors to formulate a plan and pass a resolution that its adoption was "advisable." It in terms provided for the sale of stock by the company to "any or all of its employees." The words "any or all' in statutes of this character are generally used in a distributive sense (3 *Cor. Jur.* 232, 244), and it would seem that the legislative design was to allow *any* employee in good standing to become a stockholder of the company. The only definite term or condition fixed by the "plan," however, was that the stock should not be sold below par. Everything else, the choice of employees, the amounts allotted to each, the price, terms and conditions, by express provision, were to be determined by the president pursuant to "authority to be granted" to him by the board of directors (p. 41). Under this arrangement the president did not confine his selections entirely to employees of the company (p. 22); and no rank and file employee was allowed to participate; whereas, by adopting a formula based on fixed salary and contingent compensation (p. 100)—in his own case amounting to $1,008,000 for 1930, and in the case of the vice-presidents running from $145,000 to $603,000 for the same year—he and the vice-presidents were enabled to obtain 30,125 shares out of a total of 56,712 (p. 131) at $87 a share less than the market value.

Under these circumstances, Swan, J., dissenting, was of the opinion that the plan was nothing more than a proposal; that it was not such a formulated plan as the statute contemplated. He says (p. 299):

> "It was a proposal that the stockholders abrogate the discretion which the statute vested in them to ap-

> prove or disapprove a formulated plan declared by the directors to be advisable, and confer upon the directors and president complete discretion to determine and execute in the future, without further reference to the stockholders, any sort of allotment then thought desirable, provided only that the price to employees who were selected to share in it be not less than the par of the stock. The purpose of the statute was to let the stockholders know with some definiteness—'a formulated plan'—what the directors thought advisable, and to allow the stockholders to approve it, if at least two-thirds of them also deemed it advisable. This purpose is completely frustrated if it be sufficient to submit a plan which merely proposes that the directors shall be empowered to allot stock to employees on such terms as they may thereafter please. And the undesirability of transferring to the directors complete discretion as to what plan shall be formulated in the future is particularly apparent where, as here, they are entitled to benefit under the plan. It is aptly illustrated by what in fact happened."

He then alludes to the large allotments received by the president and other directors above outlined, as illustrating the undesirability of transferring to the directors so complete a discretion. Nothing can be added to this argument. The point was not discussed in the majority opinion.

IV.

The disregard of the stockholders' pre-emptive rights.

The pre-emptive right of stockholders to subscribe to new stock was said by this Court in *Miles* v. *Safe Deposit Co.*, 259 U. S. 247, 252, to be so universally recognized as to have become "axiomatic in American corporation law."

It has always been fully recognized in New Jersey: *Way* v. *American Grease Co.*, 60 N. J. Eq. 263; *Wall* v. *Utah Copper Co.*, 70 N. J. Eq. 17; *Morganstern* v. *American Milling Co.*, 87 N. J. Eq. 358; *Graussman* v. *Porto Rico Am. Tob. Co.*, 95 N. J. Eq. 155, 165. In the latter case it was said:

"the right of the present stockholders to have a first call upon the new stock cannot be defeated by any corrupt or other plan of the directors." In *Borg* v. *International Silver Co.,* 11 Fed. (2nd) 147, 151, opinion by Learned Hand, J., it was said: "To deprive them (the stockholders) of their right of pre-emption is to change their contract."

This rule, long recognized as a part of the common law of New Jersey, was crystallized into statute law by the Act of 1926, passed six years after the employees' aid act of 1920, and before the program of 1930 was initiated. This law (G. C. A., Sec. 124; Smith, Vol. 2, p. 80) reads as follows:

> "Upon the issue of capital stock for cash, unless otherwise expressly provided in the certificate of incorporation, or in by-laws adopted by two thirds in interest of each class of stockholders, every stockholder shall have a right (unless waived by him) according to the number of shares held by him to purchase his pro rata proportion of the stock to be issued, at such price (which may be in excess of the par value), within such time and on such terms as shall be fixed and determined by the board of directors."

Inasmuch as neither by the charter nor by any by-law had this pre-emptive right been surrendered by the stockholders, it could be taken away, if at all, only by an amendment of the charter approved by two-thirds of the stockholders of all classes outstanding. Under a familiar principle of statutory construction, that statutes must be reconciled (*McKee* v. *United States,* 8 Wall. 163, 167), the Act of 1920 should be confined to those corporations which either by the original charter, or possibly an amendment thereof, have cancelled this pre-emptive right.

The majority of the Circuit Court of Appeals attempted to meet this objection by the statement that the statutory right of pre-emption applied only for an issue and sale of the stock for "cash" (p. 295).

The stock, however, *was* issued for cash, if this be the important consideration. It was sold immediately to the Guaranty Trust Company, not even an employee, at $25 a share; and was re-offered to the directors and selected list of officers

by the Guaranty Trust Company at the same price (pp. 21, 90). The Act of 1920, under which the plan was passed, does not provide for a sale for other than cash, although it authorizes the purchase price to be paid in instalments, and for company aid in paying for it.

There is even a further fundamental question of contract right involved. Under the decisions of New Jersey, the charter is a contract between the shareholders *inter sese*, which may not be changed by subsequent legislation, notwithstanding a reserved power to amend (*Kean* v. *Johnson*, 9 Eq. 401; *Zabriskie* v. *Hackensack Ry. Co.*, 18 Eq. 178, 191, 192; *Black* v. *Del. & Rar. Canal Co.*, 24 Eq. 456; *Mills* v. *The Central R. R.*, 41 Eq. 1; *Loewenthal* v. *Rubber Co.*, 52 Eq. 440, 441; *German Ins. Co.* v. *Schwarzwaelder*, 59 Eq. 589; *Re Newark Library Assn.*, 64 N. J. L. 217, 219; *Einstein* v. *Raritan Woolen Mills*, 74 Eq. 624, 629; *Itiso* v. *Met. Sav. & Loan Co.*, 68 N. J. L. 588, 590; *Colgate* v. *U. S. Leather Co.*, 75 Eq. 229; *Riker* v. *United Drug Co.*, 79 Eq. 580, 583).

If this be so, the pre-emptive right, without the stockholders' consent, could not be taken away even under the Act of 1926; certainly not under the Act of 1920. This contract right seems to be recognized in the recent case of *Scott* v. *Lorillard Co.*, 108 N. J. Eq. 153, aff'd by the Court of Errors and Appeals, 109 N. J. Eq. 417, where the case proceeded upon the assumption that under the employees' stock plan in that case, it was essential that the stockholders waive their pre-emptive rights.

V.

Disposition of assets contrary to the charter contract of the shareholders *inter sese*.

Moreover, it is evident that any construction of the Act of 1920 which would make it justfy a dissipation of corporate assets—amounting to nearly $5,000,000 with respect to only 56,712 shares out of the 312,968 available—would equally violate the plaintiff's charter contract.

The charter contained the following provision:

> "The directors of said merged corporation shall have the power to fix and determine from time to time and to vary the sum to be reserved, over and above its capital stock paid in, as a working capital, before declaring any dividends among its stockholders, * * * and to direct and determine the use and disposition of any surplus or net profits or earnings, over and above the capital stock paid in. All sums so reserved may be applied from time to time to the acquisition of property as the directors shall from time to time determine" (p. 54).

It is the plaintiff's contention that under this provision the assets of the company could be applied only (1) to put in a reserve fund to acquire property as directed by the board, or (2) to payment of dividends.

The law of New Jersey is thus stated by the highest Court of the State in *Riker* v. *United Drug Co.*, 79 N. J. Eq. 580, 583:

> "Each stockholder of the company owns a share in its property and assets, and is entitled to have a proportionate share in its profits. They have invested their capital in it, and in it alone, and they are entitled to every dollar that it earns. This is the agreement of the stockholders among themselves. They each contract with the others that their money shall be employed for the purposes specified in the certificate of incorporation, and for no other purpose, and that the profits of the enterprise shall be ratably apportioned among them. In the absence of legislation permitting a variation of the provisions of this fundamental contract, by vote of a majority of the stockholders, no majority, however large, has the right to divert any part of the joint capital, however, small, to any purpose not consistent with and growing out of this original, fundamental agreement" (citing *Black* v. *Del. & Raritan Canal Co.*, 24 N. J. Eq. 456, 463; *Mills* v. *Central Railroad Co.*, 41 Eq. 1; *Colgate* v. *U. S. Leather*, 75 Eq. 229).

The rule laid down in *Dodge* v. *Woolsey,* 18 How. 331, 341, 342, is to the same effect, where the rule was approved:

> "It is a breach of trust towards a shareholder in a joint-stock incorporated company, established for certain definite purposes prescribed by its charter, if the funds or credit of the company are, without his consent, diverted from such purpose, though the misapplication be sanctioned by the votes of the majority; and, therefore, he may file a bill in equity against the company in his own behalf, to restrain the company by injunction from any such diversion or misapplication."

It can hardly be disputed that a sale of 56,712 shares of the company's capital stock at nearly $5,000,000 less than its then value is a disposition of corporate assets. Inasmuch as the charter did not authorize such use of corporate property; and inasmuch as the authorities cited under Point IV show that the charter constitutes in New Jersey a contract among the shareholders *inter sese* not subject to alteration by a later legislative act, even under a reserved power to amend, it is submitted that the decision of the Circuit Court of Appeals allowing this to be done under cover of a later statute violated plaintiff's contract and at the same time denied him constitutional protection.

VI.

The plan in providing for a sale of stock to employees "by way of additional compensation for services to be rendered" was contrary to the provisions of Chapter 175 L., 1920, and to the general corporation law of New Jersey.

Finally, the plan three times, under the heads of "Purpose," "The Plan," and "Execution of the Plan" (p. 47), provided that the allotment of stock thereunder was "by the way of

compensation for services to be rendered." Presumably, these provisions were inserted in contemplation of what was subsequently carried out, i. e., a sale of stock at $87 a share less than its then market value. The provision has the appearance of a device intended to import consideration into a transaction which to the extent named would otherwise be wholly lacking therein. But there was no authority in the Law of 1920 for the insertion of any such provision. That act provided only for "the purchase and sale of its capital stock to any and all employees," and for its payment in instalments. It is true, it authorized the company to aid such employees in paying for such stock by contributions, compensation for services, or otherwise. But this language seems to imply a sale in the first instance at a fair price, that is to say, a price related to the actual or market value of the stock, and the application to the price of any contribution the company might make, or of any wages or salaries the employees might otherwise have earned. The statute certainly did not contemplate an issue of stock as additional compensation for services to be rendered; and any such construction of the Act of 1920 directly conflicts with the previous Act of 1917 (L. 1917, Chap. 195; Sec. 1; *Smith on N. J. Corporations,* p. 110), which provides only that a New Jersey corporation "may issue stock for the amount it actually pays for *labor performed.*" It could hardly be contended that the Act of 1920 contained even an implication that the previous Act of 1917 was modified or repealed thereby. But even if such implication were possible, it remains to be said that under the law of New Jersey, as elsewhere, repeals by implication are not favored.

The foregoing points relate to the original invalidity of the plan. I now come to deal with those points which, assuming *arguendo,* but *arguendo* only, its original validity, are directed at its subsequent execution. And the most important of these is

VII.

The violation of the directors' fiduciary obligation and waste in the sale of the stock.

The stock amounting to 56,712 shares, as has been stated, was sold by the directors at $87 a share less than its then market value. Of this amount the president received 13,440 shares, an aggregate profit of $1,169,000; the other directors, 19,330 shares, an aggregate profit of $1,681,000. The remainder was sold to higher employees (Ex. H, p. 131), with the exception of 1,780 shares sold to others ranked by the company as "miscellaneous," and not believed to be employees in the sense of either statute or plan (pp. 22, 153).

This proceeding was justified by the majority of the Circuit Court of Appeals upon the ground that "the selling price of stock on the market (which is always subject to fluctuation) will not justify an allegation of insufficient consideration amounting to fraud. The corporation received what those in charge of its internal affairs deemed to be sufficient as its par value"; that is to say, the directors, who alone in New Jersey have corporate management (Sec. 12, G. C. A.; Smith, p. 192).

Inasmuch as the error at this point is believed to be opposed to elementary principles, it may not be amiss to cite the leading cases in which those principles were first formulated; and then to inquire whether the "inflexible" rule therein laid down has been relaxed.

The leading cases seem to be *Ex parte James*, 8 Ves. Jun. 337, decided by Lord Eldon in 1803; *Davoue* v. *Fanning*, 2 John. Ch. 252, decided by Chancellor Kent in 1816; *Michoud* v. *Girod*, 4 How. 503, decided by this Court in 1854; and *Aberdeen Ry. Co.* v. *Blakie Brothers*, 1 MacQueen's App. Cas. 461, decided by the House of Lords in 1854.

In *Ex parte James*, Lord Eldon declared (p. 345):

> "The doctrine as to purchases by trustees, assignees and persons having a confidential character stands much more upon general principle than upon the circumstances of any individual case. It rests upon this:

> that the purchase is not permitted in any case, however honestly the circumstances, the general interests of justice requiring it to be destroyed in every case; as no court is equal to the examination and ascertainment of the truth in much the greater number of cases."

In *Davoue* v. *Fanning,* it was held that, where the trustee, or person acting for others, becomes interested in the purchase, the *cestui que trust* is entitled as of course to have the sale set aside; and that it makes no difference that the sale was at public auction, at a fair price, or that the trustee purchased for a third person. Dealing with the "true principle" the Chancellor observed (p. 260):

> "However innocent the purchase may be in the given case, *it is poisonous in its consequences* * * *. There may be fraud, as Lord Hardwick observed, and the party not able to prove it. It is to guard against this uncertainty and *hazard* of abuse and to remove the trustee from temptation, that the rule does and will permit the cestui que trust to come at his own option, and without showing actual injury, and insist upon * * * another sale." (The italics are the Court's.)

In *Michoud* v. *Girod,* after an elaborate review of all the precedents, concluding with *Davoue* v. *Fanning,* of which case it was declared that it was not too much to say that it had "secured the triumph of the rule over all qualification and relaxation of it in the United States to the same extent that had been achieved for it in England by that great chancellor, Lord Eldon" (p. 556), this Court laid down the rule broadly that a purchase by a trustee is *fraudulent* and *void,* although a fair price be paid. The Court said, no one dissenting:

> "The general rule stands upon our great moral obligation to refrain from placing ourselves in relations which ordinarily excite a conflict between self-interest and integrity. It restrains all agents, public and private; but the value of the prohibition is most felt, and its application is more frequent, in the private relations in which the vendor and purchaser may

> stand towards each other. The disability to purchase is a consequence of that relation between them which imposes on the one a duty to protect the interest of the other, from the faithful discharge of which duty his own personal interest may withdraw him. In this conflict of interest, the law wisely interposes. It acts not on the possibility, that, in some cases, the sense of that duty may prevail over the motives of self-interest, but it provides against the probability in many cases, and the danger in all cases, that the dictates of self-interest will exercise a predominant influence, and supersede that of duty. It therefore prohibits a party from purchasing on his own account that which his duty or trust requires him to sell on account of another, and from purchasing on account of another that which he sells on his own account. In effect, he is not allowed to unite the two opposite characters of buyer and seller, because his interests, when he is the seller or buyer on his own account, are directly conflicting with those of the person on whose account he buys or sells."

In *Aberdeen Railway Co.* v. *Blakie Brothers,* the doctrine of the foregoing cases was first applied to corporate directors. A director there had purchased for the railway company certain iron chairs from a firm in which he was a partner. Opinions were rendered by the Lord Chancellor Cranworth and by Lord Brougham. The Lord Chancellor said (p. 471):

> "A corporate body can only act by agents, and it is of course the duty of those agents so to act as best to promote the interests of the corporation whose affairs they are conducting. Such agents have duties to discharge of a fiduciary nature towards their principal. And it is a rule of universal application that no one, having such duties to discharge, shall be allowed to enter into engagements in which he has, or *can have,* a personal interest conflicting, *or which may possibly conflict,* with the interests of those whom he is bound to protect. So strictly is this principle adhered to that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into. * * * So inflexible is the rule that no inquiry on that subject is permitted." (Italics not the Court's.)

The doctrine of these pioneer authorities has never been weakened in this Court by what elsewhere has been aptly called "disintegrating erosion" (*Wendt* v. *Fischer,* 243 N. Y. 439, 444).

The decision in *Michoud* v. *Girod* was later approved in *Magruder* v. *Drury,* 235 U. S. 106, 119, which the concluding part of the language above set out was quoted and the succinct statement made:

> "A trustee can make no profit out of his trust."

In *Jackson* v. *Smith,* 254 U. S. 586, 589, the doctrine of *Michoud* v. *Girod* was again followed.

The latest case in this Court in which *Michoud* v. *Girod* is approved is *United States* v. *Dunn,* 268 U. S. 121, 131, where it was said:

> "It is sufficient to establish that the fiduciary has exercised his power of disposition for his own benefit without more."

See also: *Wardell* v. *Railroad Co.,* 103 U. S. 651, 658.

The uncompromising attitude of later-day courts with respect to this doctrine is thus stated in a recent decision of the Court of Appeals of the State of New York (*Meinhard* v. *Salmon,* 249 N. Y. 458, 464), where the Court was dealing with the subject of loyalties between partners:

> "A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity, when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions (Wendt v. Fischer, 243 N. Y. 439, 444). Only thus has the level for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court."

It would seem that the authority of the foregoing cases goes far beyond the requirements of the case at bar; for the stock here was sold by the director-trustees largely to themselves at a mere fraction of its real value, under circumstances showing a self-consciousness of wrongdoing. In *Michoud* v. *Girod,* circumstances much less reprehensible were declared by this Court as a matter of law to be fraudulent and void.

The defense of the directors, so far as can be gathered from their previous arguments, appears to be that, under the terms of the plan, which they "advised," they were qualified to become purchasers of the stock. They apparently rely upon the following provision (p. 49):

> "No employee or person actively engaged in the conduct of the business of the corporation, or its subsidiaries, shall be deemed ineligible to the benefits of the plan by reason of his being also a director of the corporation or of any of its subsidiaries or of holding any office therein."

The effect of this clause as rendering the initial resolution void and of no effect has been adverted to under Point I. At this place it is only necessary to point out that nothing in this clause justified the directors in selling three-fifths of the stock to themselves at one-fifth of its value. The fact that the plan placed a minimum of par below which the stock could not be sold certainly could not have that effect. As the president himself said, when soliciting proxies for the meeting, under circumstances heretofore mentioned, that clause simply meant, "subscriptions under the plan must be at a minimum but by no means or necessity a maximum price of $25 a share" (p. 50). The elementary duty of the directors, even if they were justified in including themselves, which cannot be conceded, to sell to all employees at at least a fair value, remained unaffected.

The argument here, however, would seem to be foreclosed by the observation of this Court in *Michoud* v. *Girod, ubi supra.* Dealing with the exception that a purchase by a trustee of his *cestui que trust,* provided that it is deliberately

agreed or understood between them that the relation shall be dissolved, and that there is no fraud, concealment or advantage taken by the trustee (circumstances lacking here) will be sustained in a court of equity, was careful to add (4 How., at p. 556):

> "But it is difficult to make out such a case where the exception is taken, especially where there is any inadequacy of price or any inequality of the bargain."

And so likewise in *Twin Lick Oil Co.* v. *Marbury,* 91 U. S. 587, treating of the exception that where a director had loaned needed money to his company and taken security, he might protect himself by buying in the property at a fair price at public sale, the Court nevertheless said that it was a "doctrine founded on the soundest morality" that such a transaction might be set aside on "slight ground"; and the principle was again reiterated that a transaction where an agent to sell buys of himself was "void."

Finally, to repeat what was said in the recent case of *United States* v. *Dunn,* 268 U. S. 121, 131:

> "It is sufficient to establish that the fiduciary has exercised his power of disposition for his own benefit without more."

Although the matter here is governed by the principles of general equity jurisprudence, as to which this Court will exercise its own judgment (*Russell* v. *Southard,* 12 How. 139, 147), it can be said that the doctrine of the courts in New Jersey is in accord with the principles laid down in this tribunal.

In *Booth* v. *Beattie,* 95 N. J. Eq. 776, the Court of Errors and Appeals approved this statement of the law:

> "The rule is that contracts made by a board of directors with one of their own number are, regardless of merits, voidable at the option of a dissatisfied stockholder, while such contracts sanctioned by a majority of the stockholders will be set aside by a court if it is disadvantageous to the minority stockholders. Equity will investigate."

In *Marr* v. *Marr,* 73 N. J. Eq. 643, 650, Judge Pitney declared that where a director purchased corporate property even at a sheriff's sale it was a controlling circumstance that the director purchased at half the value.

In *Barry* v. *Moeller,* 68 N. J. Eq., at p. 489, it was said by Garrison, J.:

> "In cases where sales of property of the corporation are made to directors, the latter are charged with the full value of the property received, the contract price as fixed by the wrongdoer being completely disregarded."

In conclusion, it is respectfully submitted that to permit a rule to be established in the highest Federal court in so important a commercial community as New York, to the effect that directors may sell stock to themselves or any others at one-fifth of its market value because stock has a fluctuating value, or because that is a matter of internal control, will imperil the rights of stockholders everywhere.

VIII.

The resolutions authorized the sale of the stock as aforesaid were invalid, inasmuch as they were not passed by a quorum of a board of disinterested directors.

The law upon this subject, with supporting authorities, has been set out under Point I.

An examination of the minutes of the directors' meeting of January 28, 1931, when the stock was distributed (Ex. F, p. 79), show that at this meeting every director present had already been selected by Mr. Hill, the president, for his quota of stock. The directors then approved in rotation the allotment to each director, every director being recorded as not voting on his own allotment, but as voting in favor of the distribution to all other directors. It is needless to say that each director immediately availed himself of the privi-

lege thus manipulated (complaint, p. 24; answer, p. 191; Ex. H, p. 131).

It would be difficult to imagine a situation more clearly revealing a self-consciousness of impropriety upon the part of the directors; or the adoption of a more ineffective device to escape it. It has been expressly held that voting in rotation has the same effect as if each director voted upon his own proposition (*McNab* v. *McNab & Harlin Mfg. Co.*, 62 Hun 18, 22; aff'd by the Court of Appeals, 133 N. Y. 687).

IX.

The sale of the stock "by way of additional compensation for services to be rendered to and including December 31, 1931," i. e., from January 28 to December 31, 1931, was invalid.

On January 28, 1931, based upon the experience of the calendar year just closed, the president was already receiving in fixed salary and cash bonus $1,010,000 a year; four vice-presidents, $450,000 to $555,000 a year each; one, Taylor, $50,000 a year; and all other employees the ample compensation set out in Exhibit H, page 131. It was altogether unlikely that this additional consideration amounting to approximately $5,000,000 for 528 employees was necessary to glue them to their posts for a further period of eleven months. Evidently, therefore, this formula was nothing more than a conveyancer's device invented to import consideration into a transaction which was recognized as otherwise lacking of adequate consideration.

The device was, however, unavailing, because Chapter 175, Laws of 1920, did not authorize stock to be sold to employees "by way of compensation to be rendered"; while, upon the other hand, the General Corporation Law authorized stock to be issued only "for labor performed" (L. 1917, Chap. 195, Sec. 1; Smith, p. 110).

The proceedings authorized at this meeting were likewise invalid in the following additional particulars:

The sale in the first instance was a sale to the defendant Guaranty Trust Company, which was not an employee of The American Tobacco Company. It was, therefore, a sale to an outsider contrary to the very terms of the plan.

Among the participants approved by the directors were the individual trustee, associated with the Trust Company; an individual member of the law firm which was counsel to the Tobacco Company; the advertising agent; and two others: all grouped by the company itself under the head of "Miscellaneous" (p. 153); and not properly "employees" in the sense of the plan.

Moreover, the plan did not in fact provide for the interposition of trustees, even though under the statute it might have so provided.

X.

The District Court had jurisdiction of the consolidated cause.

The District Court admitted jurisdiction, but declined to exercise it "in its discretion," because it presented questions for construction of New Jersey statutes (p. 281). The Circuit Court of Appeals affirmed the decree below; although it actually assumed jurisdiction and discussed the case upon the merits. In their reply to the petition for a certiorari, the defendants have taken the position that the jurisdictional question was out of the case and that "this Court would concern itself solely with the question whether the dismissal of the complaints was proper under the applicable New Jersey law." As all parties are now agreed, it would seem unnecessary to discuss this question. As Chief Justice Marshall once said (*Mason* v. *The Blaireau*, 2 Cr. 240):

> "Whatever doubts may exist in cases where the jurisdiction may be objected to there ought to be none where the parties assent to it."

It may be said, however, that the District Court in declining as a discretionary matter to exercise an admitted jurisdiction was proceeding contrary to law.

The undisputed facts are that The American Tobacco Company was licensed to do business under the laws of New York, with its principal place of business in New York City, where its chief executives have their offices, where its board of directors customarily meets, and where its principal records are kept. Only one director, the sole individual defendant with the Tobacco Company in the first of the consolidated causes, is a resident of New Jersey. The stock sought to be cancelled is in the possession of the Guaranty Trust Company, a New York corporation which could not be reached in New Jersey, and which is a party to the second consolidated cause. Under these circumstances, the decision of the Circuit Court of Appeals in *Williamson* v. *Missouri-Kansas Pipe Line Co.*, 56 Fed. (2nd) 503, 511, is applicable. The Court there said:

> "Bearing upon the question of expediency, convenience, and power to effectuate a decree in case one should be rendered, each appellee has all of its books and records, its principal office, most of its business, many of its officers and directors, including its president, and part of its assets within this jurisdiction, and neither is doing any business in Delaware, or maintaining any office in that State except as is necessary under the laws of Delaware to maintain its corporate existence. Each appellee is licensed to do business in Illinois, and has been served with process in this cause. Under the allegations of the bill we think that considerations of neither justice nor expediency point to the courts of Delaware as the appropriate tribunals to investigate and determine the charges made in the bill as against Parish & Co., and that the District Court has ample power to effectuate any judgment it may render, under the evidence, against Parish & Co. We think the trial court erred in declining to exercise jurisdiction."

Apart from this authority, the case was in the District Court by reason of diverse citizenship. There were also involved one or more Federal questions. Under either aspect

the District Court could not decline jurisdiction, for the reason thus expressed in *Suydam* v. *Broadnax*, 14 Pet. 67, 75:

> "The 11th section of the act to establish the judicial courts of the United States carries out the constitutional right of a citizen of one State to sue a citizen of another State in the circuit court of the United States, and gives the circuit court 'original cognizance, concurrent with the courts of the several states, of all suits of a civil nature, at common law, and in equity,' &c., &c. It was certainly intended to give to suitors, having a right to sue in the circuit court, remedies coextensive with these rights."

In *Hyde* v. *Stone*, 20 How. 170, 175, it was said that the Federal courts are bound to afford redress to suitors in every case to which their jurisdiction extends:

> "They cannot abdicate their authority or duty in any case in favor of another jurisdiction."

See also, *Chicot* v. *Sherwood*, 148 U. S. 529, 534; *McClellan* v. *Carland*, 217 U. S. 268, 281; *Kline* v. *Burke*, 260 U. S. 226, 230.

In any event

> "dismissal must rest on the ground that there was want of equity, not on lack of jurisdiction."
>
> *Burnrite Briquette Co.* v. *Riggs*, 274 U. S. 208, 213.

XI.

Alleged failure to comply with Equity Rule 27.

The majority opinion (p. 296) holds that petitioner is barred because of failure to combine with two other stockholders and call a meeting to cancel the employees' stock plan under Sec. 46 of the General Corporation Act of New Jersey (Chap. 185, L. 1896; Smith, p. 228), which provides that three or more stockholders of New Jersey corporations

may call a stockholders' meeting. To say nothing of the prohibitive cost and practical impossibility of petitioner's calling a meeting of stockholders of so large a company, it is submitted that this decision (1) disregards the actual situation here presented, and (2) violates the reason of Rule 27.

The dissenting opinion of Swan, J. (p. 301), deals with this question. The petitioner will, therefore, only briefly summarize the reasons why under the facts of this case Rule 27 had no application.

First, the plan is claimed to be illegal. If so, there is nothing to repeal.

Second, if the plan could be considered legal, it was wastefully carried out, and in a manner contrary to its very terms. Evidently in this latter aspect the plan does not require repeal.

Third, the plan itself requires any repeal or modification to be carried out under the provisions of Chapter 175, Laws of 1920. This act in turn requires a repeal to be effected in the same manner as the plan is passed, i. e., as a condition precedent to a stockholders' meeting the board of directors must first pass a resolution "advising" repeal. As the board of directors are all pecuniarily interested, have all participated in the benefits of the plan, have declined to sue on written demand (pp. 17, 18), and have actively defended this action, relief through this channel is obviously impossible.

In *Hawes* v. *Oakland*, 104 U. S. 450, 461, out of which Rule 27 grew, an appeal to stockholders was said to be unnecessary where "it was not *reasonable* to require it." In the leading case of *Del. & Hud.* v. *Al. & Susquehanna R. R. Co.*, 213 U. S. 435, 440, 452, it was said the rule "is intended to have a *practical* operation, and to have that it must, as to its requirements, be given such play as to fit the conditions of different cases." The rule itself provides for an appeal to stockholders only where "*necessary.*"

An instructive case upon this point is *Continental Securities Co.* v. *Belmont*, 206 N. Y. 7, 15, 19, where this very question was the main point decided. In that case it was held that it was not necessary for a complaining stockholder,

in addition to alleging a demand upon the directors to bring the action and their neglect and refusal to do so, to allege that he had given notice of the alleged fraud to the stockholders and had demanded of them that some action be taken by them to redress the wrong. The Court pointed out that under the law of New York stockholders cannot act in relation to the ordinary business of the corporation. The same rule prevails in New Jersey (Sec. 12, G. C. A.; Smith, p. 192). After an extended discussion, the Court concluded with the following observations on the rule in *Hawes* v. *Oakland:*

> "The decision reported in Hawes v. Oakland (104 U. S. 450) and other similar decisions in the Federal and state courts are not in conflict with the decision about to be rendered herein. In such cases, as in this case, it is asserted that an application to the body of stockholders is unnecessary when it is unreasonable to require it. If the body of stockholders has no adequate power or authority to remedy the wrong asserted by the individual stockholders it is unreasonable and unnecessary to require an application to it to redress the wrong before bringing a representative action."

With the vast increase in the size of the corporations in this country it must be increasingly evident that an appeal to stockholders by a single stockholder to overthrow a seated management is a futile remedy (see opinion of Swan, J., p. 300). Such a requirement would effectually amount to a denial of justice in many cases, and give to Rule 27 that impractical application which this Court has condemned. In the case at bar, however, for the reasons stated, Rule 27 had no application.

Even less is to be said of the comment in the majority opinion that in the spring of 1931 the stockholders re-elected the old board. As said in *Continental Securities Co.* v. *Belmont, supra,* at p. 17, in a similar connection:

> "For reasons wholly apart from the matter in dispute the stockholders may not desire to change a majority of the persons comprising its board of directors."

Fourth Separate Defense.

This defense sets forth in great detail the progress of the company and the accomplishments of the management, particularly the president, in that connection. The majority opinion below dwells at some length upon these circumstances; but it is obvious that none of the allegations in that regard are relevant to the issues raised by the complaint.

In *Jacobson* v. *Brooklyn Lumber Co.*, 184 N. Y. 152, 161, dealing with a similar question, the Court of Appeals of New York said:

> "If the individual defendants have illegally and wrongfully occasioned a loss to the defendant corporation, it is neither a defense nor a mitigating circumstance that despite such illegal and wrongful acts the corporation is still solvent, or that the stock has increased in value during the time when the alleged illegal and wrongful acts have been committed. (*Kavanaugh* v. *Commonwealth Trust Co.*, 181 N. Y. 121.)
>
> Neither the good faith, honesty nor legality of the acts of officers of a corporation can be determined by ascertaining whether the market value of the capital stock of the corporation has increased or diminished during the time when said acts were performed. A corporation may lose money notwithstanding good, faithful, honest endeavor by its officers, and it may increase its assets notwithstanding selfish and illegal acts by them."

To the same effect was the decision of the New York Court on the application for an examination of the company's books; cited under Point II (*ante*, p. 14) of this brief.

CONCLUSION.

The facts are all before this Court; no further issues remain to be presented; if a wrong has been committed, immediate and final injunctive relief is required to prevent irreparable injury, inasmuch as there is at present no legal barrier to the distribution of the stock now in the hands of the Guaranty Trust Company, or to a similar disposition by the directors of the balance claimed to be available. The plaintiff, therefore, indulges the hope that this Court may see its way clear to make a final disposition of this cause (*Mast. Foos & Co.* v. *Stover Mfg. Co.*, 177 U. S. 485, 495).

Respectfully submitted,

RICHARD REID ROGERS,
Petitioner, *pro se.*

EVAN SHELBY,
of Counsel.